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RUEHOK/AMCONSUL OSAKA KOBE 3333  
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UNCLAS SECTION 01 OF 09 TOKYO 000645

SIPDIS

PARIS PLEASE PASS TO USOEDC  
STATE PLEASE PASS TO USTR

SIPDIS

SENSITIVE

E.O. 12958: N/A

TAGS: ETRD ECON JA ZO EAGR

SUBJECT: The Japan Economic Scope - February 9, 2007

Sensitive but unclassified. Please protect accordingly.

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¶2. (U) This cable contains the Japan Economic Scope from February 9, 2007.

¶3. (SBU) Inbound FDI Negative for 2006, Japan Likely to Miss Five-Year FDI Target  
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In 2006, Japan experienced a net outflow of foreign direct investment by non-residents for the first time in 17 years.

According to Ministry of Finance figures, total FDI inflow to Japan by non-residents was 4.93 trillion yen (\$42.5 billion), up almost 50% from 2005. Unfortunately, disinvestment by non-Japanese investors in the same period was 5.67 trillion yen or \$49.1 billion. The difference was a net outflow of FDI of 740 billion yen (\$6.6 billion.)

The biggest contributing factor was the sale by British firm Vodafone of its Japan operations to Softbank in April 2006 for \$16.3 billion. The same month, General Motors Corporation sold a 17 percent stake in Suzuki Motors for \$1.98 billion. These two deals contributed to a net outflow of \$14.8 billion in the month of April 2006 alone. Without these two large disinvestments, Japan's FDI flows in the first 11 months of 2006 would have been a respectable \$11.68 billion, up from \$2.8 billion in 2005 and \$7.8 billion in 2004.

As a result of these disappointing numbers, Japan will almost certainly fail to meet the target set by former Prime Minister Koizumi of doubling the nation's stock of FDI from its 2001 level within five years. In nominal terms that target translates into 13.2 trillion yen (\$119 billion) of FDI by the end of 2006. With only one month's figures left to be booked, Japan's year-end stock of FDI likely will be only about 11 trillion yen.

See the attached Excel document for MOF's month-by-month figures for FDI flows.

14. (SBU) Keidanren Chairman Visits Australia, Wants an FTA

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No talks have started yet since their launch was announced, but the Japanese continue to discuss the merits of a free trade -- or economic partnership -- agreement with Australia.

Fujio Mitarai, Chairman of the Japan Business Federation (Keidanren), visited Australia the first week in February, meeting with government officials including Prime Minister John Howard and his counterparts in the Australian business community. Mitarai underscored Keidanren's support for a deal. He pointed to the difficulties of getting Japan's agricultural sector on board and suggested that one way forward would be to phase in tariff reductions over a 10-20 year period. For his part, according to press reports, Howard emphasized that he wanted to see key agricultural products on the table in the negotiations. A MOFA official we talked to February 8 told us that Howard's strong public line underscores how "clever" he has been in handling the launch of the talks. Note, the MOFA official said, that Howard called for "some movement" on agriculture. The GOJ expects the Australians to be flexible when the talks begin, and "some" more accurately translates into not much.

For more on Keidanren's views about a Japan-Australia FTA, click [here](#).

15. (SBU) Japanese Reaction to U.S. WTO Subsidy Case Against China  
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The Japanese press has covered extensively the U.S. decision late last week to file a subsidy case against China. After the announcement, Japanese Trade Minister Amari indicated Japan may join the case as a third party. He told reporters that U.S. Trade Representative Susan Schwab had asked him last month if Japan would be interested in joining the United States in filing the complaint together.

Consultations with the Japanese on the possibility for a joint-filing had been on-going for several months prior to the February

2 action. Noteworthy among these discussions was a series of working level meetings between USTR officials and their MOFA/METI counterparts to identify common ground for joint-action -- the process of which began with an exchange of information on related areas of concern last May.

According to Kyodo news, however, Amari has hinted that Japan would likely take a "softer" third party approach, because many Japanese companies run joint ventures with Chinese partners and capital. A Nikkei editorial noted that the United States had moved quickly since its December Strategic Dialogue meetings with the Chinese to take a hard-line approach against Beijing. In part, the newspaper notes, USTR is compelled to show a tough posture to satisfy Congress in advance of a request to extend Trade Promotion Authority.

[Click here](#) to read Ambassador's Schwab's remarks and [click here](#) to read a recent press release.

#### 16. The New Reg Reform Council Launched

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Japan's new Council on Regulatory Reform was officially established in January, taking over the mandate of the Council on the Promotion of Regulatory Reform and the Office of Trade and Investment Ombudsman.

Chaired by Takao Kusakari, its 15 members include eight experts who served in the previous Council. In its first meeting on January 31, the Council identified some key issues reflecting Prime Minister Abe's priorities: promote innovation, raise productivity; build an open economy and society; realize high standards of living; revitalize regions; and realize a society with "a second chance." It is not yet clear, however, how these goals will translate into deregulation policies. The Council is expected to issue a report in late May, and the Cabinet will adopt a new Three-year Regulatory Reform Plan soon

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after.

See Tokyo 387 and 154 for more details. Also, for more information in English [click here](#) and for more information in Japanese [click here](#).

#### 17. (SBU) Meets Niigata and Kanagawa Prefecture Governors

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On February 1 in Niigata and February 5 in Yokohama, EMIN met respectively with the governors of Niigata and Kanagawa prefectures.

Although their current economic situations differ (Kanagawa's is booming, becoming a national center for biotechnology and R&D, while stereotypically rural Niigata barely has been able to stay abreast of the national average growth rate), both governors pressed their case to host jointly the next G-8 summit in 2008. Niigata and Yokohama have filed a joint application to host the summit -- foreign and finance ministers would meet on the west coast in Niigata, while Yokohama would receive the leaders' meeting. They both see Kyoto as their main competition. While they would welcome the prestige that accompanies hosting a G-8 summit meeting, Kanagawa governor Matsuzawa was explicit that winning such a bid comes with high costs: the prefectures largely are expected to pick up the enormous fees for providing police and security protection. Given the recent trend for summits to be located in remote resort areas, governor Matsuzawa was less than wholeheartedly enthusiastic about securing victory.

#### 18. (SBU) Central Asian Countries Discuss Improving Infrastructure in the Region

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The Japanese government held its Second Tokyo Dialogue on Central Asia Plus Japan on January 30 during which representatives from Kazakhstan, Tajikistan, Turkmenistan, Kyrgyzstan and Uzbekistan

as well as officials from Japanese industry and government discussed regional cooperation on water resources, electric power and the diversification of Central Asia's energy supply routes. The Central Asian countries are seeking non-European customers for their energy and so have turned to Japan for its financial and technological cooperation to develop and modernize their respective infrastructures. They also want more oil and gas exploration to increase production and export.

For Japan, Central Asia is attractive from an energy standpoint but poses geographical problems such as the lack of sea access and the volatile southern border with Afghanistan and Pakistan. Success for Japanese business and government will require a long-term commitment in the region, but that will require political stability and transparent decision-making processes. Central Asian countries stand ready to turn to Russia or China if Japan hesitates, despite their heavy-handed influence in the region.

Japan Agency for Natural Resources and Energy Petroleum and Natural Gas Division Deputy Director Kazuhiro Iwatani emphasized Japan's need to diversify supply away from the Middle East and called on the central Asian countries to cooperate on improving the investment climate to meet Japan's efforts to provide funding, technology and human resources.

Former Japanese Ambassador to Uzbekistan and Tajikistan Akio Kawato expressed his disappointment that the region's supply of uranium was not discussed during the dialogue and proposed that nuclear power plants be built in the region. He also expressed concern over the lack of security in the southern regions bordering Afghanistan and Pakistan and suggested that Japan send a peace-keeping force to the area.

#### ¶9. (SBU) M&As Continue to Expand in Kyushu

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Kyushu is no exception to a recent M&A boom in Japan, which reached a record high in 2006.

According to M&A consultancy Recof Corp, the value of M&As

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involving Kyushu, including Okinawa, firms nearly quadrupled to Yen 324.8 billion (\$2.7 billion) in 2006 from Yen 83.5 billion (\$696 million) in 2005.

The number of M&A transactions (140 cases) in the region in 2006, also a record, was up about 7 percent from the previous year. A Recof official noted that a call for structural reform, succession problems in small-medium companies, a declining birthrate and aging population, and a renewed perspective of M&A by top management are among the major factors behind this upsurge.

The official predicts the number of M&As to continue to increase in Kyushu, with growth particularly strong in Okinawa. In addition, he expects that heavily regulated sectors, including financial and transportation services, will maintain a significant role in M&A activity throughout the region.

#### ¶10. (SBU) METI Tasks Independent Study Group To Review Security Criteria for Investment

METI has established an outside study group to recommend possible revisions to rules governing which sectors require prior notification and government approval for foreign direct investment.

The group's report, due in April, will feed into formal recommendations from the ministry about whether changes are needed to the Foreign Exchange and Foreign Trade Control Law. The December announcement of the study group's formation coincided with a call from Keidanren for stricter national security review of inward M&A, but METI insists the timing is coincidental.

The chairman of the study group told the Embassy he did not expect his group to recommend significant new restrictions on inward FDI.

For more information see Tokyo 454.

¶10. (U) Opposition Takes Another Swipe at Government Over "White Collar Exemption" Bill

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In a TV Asahi news roundtable devoted to measures to address Japan's growing "social gaps" and improve the nation's pension system, a Japan Communist Party Diet member criticized the Abe Administration for drafting a bill (since withdrawn) to decrease the number of workers eligible for overtime pay "under pressure" from the Japan Business Federation (Keidanren), the ACCJ, and the U.S. Government.

In fact, reducing the eligibility for overtime for white-collar workers earning above nine million yen (\$75,000) annually is one of the United States' labor mobility recommendations at the bi-annual Investment Initiative talks.

Another commentator, reflecting negative press coverage of the draft bill, described it as leading to a "no-overtime-pay" system rather than a "go-home-on-time" system.

¶11. (U) Embassy Outreach on Bilateral Economic Relationship in Niigata and Ibaraki

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EMIN recently had the opportunity to speak to groups in Mito and Niigata, two large cities north of Tokyo on the bilateral economic and trade relationship.

His basic message was that the U.S.-Japan economic relationship is in pretty good shape compared to that 10 or 20 years ago, but we should not be complacent and instead continue to push for reform and a further opening of Japan to foreign investment, goods and services.

He acknowledged U.S. and Japanese industry's appeal for a bilateral FTA, cautioned that further reform, especially of Japan's agricultural sector, is first necessary, and asked his audiences if Japan is ready to undertake such reform.

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U.S. hopes and views for civil, regulatory reform and postal privatization were also reviewed.

¶12. (SBU) Former CEFP Member Yoshikawa Talks Critically about Japan's Economy

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University of Tokyo Professor Hiroshi Yoshikawa had both praise and criticism for the current state of the Japanese economy at a lunch seminar hosted by the Maison franco japonaise on February 2. He spoke glowingly of the years he spent as a private sector member of former Prime Minister Junichiro Koizumi's Council for Economic and Fiscal Policy (CEFP), noting in particular Koizumi's leadership of the Council and the fact that the former prime minister had attended nearly all of the 200 CEFP meetings during his tenure, which added greatly to the Council's effectiveness. Yoshikawa remains concerned over Japan's low consumption rate and its high youth unemployment rate--about 10 percent for people between the ages of 15 and 24. One in three young people works only part-time, he said, and over 700,000 are classified as NEET, a British term meaning "not in employment, education or training."

Yoshikawa raised Japan's public debt-to-GDP ratio of 150 percent, the worst among OECD countries, and compared Japan to Great Britain after WWII, whose public debt-to-GDP ratio at the time was 200 percent. Yoshikawa described two groups of thought on shrinking the ratio, one headed by Hidenao Nakagawa that

advocates achieving primary balance, and the other headed by Kaoru Yosano backing an increase in the growth rate; Yoshikawa places himself in the second group.

Another concern is the Japanese government's growing social security obligations due to the aging population. Yoshikawa pointed out, however, that Japan's capital expenditures and technological progress historically have had a much greater impact on GDP than labor, and he gave two examples: During 1955-70 Japan's labor force grew only one percent while real GDP grew 9.6 percent--similar to China's present GDP growth rate. Not quite as spectacular but not insignificant either, Japan's labor force again grew only one percent during 1975-90 while real GDP grew 4.6 percent.

Yoshikawa noted that raising the consumption tax would be necessary to fund social security and ruled out increasing income tax, because a large number of Japanese successfully avoid paying the tax, as well as increasing corporate tax, because corporate tax in Japan is already high compared to other financial centers. Yoshikawa commented that Tokyo should worry more about competing with Hong Kong and Singapore to become a world financial center than New York and London and said pointedly that Japan is not open enough. In particular, he criticized Tokyo traffic, the distance from the city center to Narita Airport, and the lack of adequate English signs.

Yoshikawa also took the University of Tokyo to task. Despite its ranking by the London Times as 11th or 12th in the world, he said non-Japanese professors make up a paltry one percent of its teaching ranks, unheard of in most other top-ranked schools.

**¶13. (U) Japanese Customs Cracks Down on Counterfeits Imported for Individual Use**

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Japanese Customs officials announced this week that they will step up inspections of luxury goods imported by individuals to intercept more counterfeits.

In mid-2006, Japan's Customs began examining more name-brand goods that individuals were bringing in, including packages addressed to individuals. They found that more and more fakes are being brought into Japan for resale under the guise of personal use, which is still legal in Japan. Most of the goods were purses and wallets and more than 80 percent of the counterfeits came from China.

METI and the IP Strategy Headquarters have told the Embassy that

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they back bills to outlaw individual imports of fakes and to ban advertising of counterfeits in online auctions, an increasingly popular way to bring in fakes.

Coach told Embassy during a recent visit that it is now the number two luxury brand in Japan in dollar terms after Louis Vuitton.

**¶14. (SBU) Agriculture: Japan's Farmers to Get Their Voice in Washington**

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Japan's Central Union of Agricultural Cooperatives (JA), the country's chief farmers' lobbying arm, is dispatching a senior official to Washington on February 11 to sign a contract with a well known law firm to represent its interests in the United States better. During a meeting at JA headquarters February 8, Executive Director Shigeo Fuji told us the Japanese Embassy was making arrangements for his visit.

Fuji would not tell us which law firm the organization had selected to represent it, but the firm enjoys a high lobbying profile. Fuji said JA would employ a full time representative at the firm to do its bidding. JA is famous in Japan for its unbending opposition to expanded agricultural trade, either

through the Doha Round or in Japan's bilateral negotiations, including the one set to begin with Australia.

115. (SBU) Last Chance for Japanese Farmers?

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The second Task Force meeting under the auspices of the Council of Economic and Fiscal Policy to review economic partnership agreements and agriculture reforms met on February 7.

According to the Japan Agriculture News, the group discussed mid- and long-term strategies for forging partnership agreements. A source we have on the Task Force told us that its function is in part to provide the "naiatsu," or domestic pressure, on Japan's farm sector to get it to reform.

According to our source, absent another round of significant agricultural reforms -- following up on last year's reforms which included the introduction of direct payments and measures intended to promote farm consolidation -- Japan's farm sector will begin to diminish.

Our source, an agricultural economist, sees a future for Japanese farmers, but only if they become much more productive.

116. (U) Holy Cow, Beef Is Expensive!

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On February 5, Japan's Ministry of Agriculture, Forestry, and Fisheries (MAFF) reported that retail prices for domestically produced beef are at their highest level in three and a half years.

Retail prices for short loin beef averaged \$26.76/lb (or 718 yen per 100 grams). Import restrictions on U.S. beef, high feed prices, and strong demand for sukiyaki and other winter dishes are responsible for the high prices.

In the United States, the USDA-reported wholesale price for a similar cut was \$4.67/lb in the same period.

117. (U) Japan's 32nd Case of BSE May Raise Questions  
On February 5, 2007, Japan's Ministry of Health, Labor, and Welfare (MHLW) announced Japan's 32nd case of BSE (mad cow).

Japan banned the use of ruminant meat and bone meal (MBM) in cattle feed on September 18, 2001, and a few weeks later extended the feed ban to all animals.

The infected cow was born in August 2001, potentially raising questions about the enforcement of Japan's feed rules. Meat from the Hokkaido-born Holstein cow was destroyed and did not enter commerce.

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Japan remains the only country in Asia that is officially recognized as having BSE.

118. (U) Ban on U.S. Potatoes Lifted

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On Wednesday the Government of Japan agreed to lift the reinstated ban on U.S. grown potatoes. This action will allow fresh U.S. potatoes to come to Japan under a strict protocol that was agreed to about a year ago.

Under the protocol, fresh potatoes must come from approved states that were visited by MAFF, be cleaned in the United States before shipping, sent inside special bags inside of a special sealed container, inspected upon import and sent directly to an approved controlled potato chip manufacturing facility near the port, to be made into potato chips.

There are numerous other measures to mitigate potential risks such as the washing of containers after loading, special double

doors in the chipping facility, and special measures for disposing of peels and waste material.

The protocol also includes a seasonal restriction, allowing shipping between February 1 and June 30. This season restriction has nothing to do with phytosanitary concerns and was meant to appease Japanese domestic growers who do want to limit access to the fresh potato market.

Domestic growers are nonetheless opposed to the protocol, even though the Japanese chip manufacturers claim that the domestic industry is not able to supply them with enough potatoes to keep their factories running throughout the year.

Potatoes from the United States were imported for the first time in 2006 under this protocol until a new pest, white cyst nematode, was found in Idaho. At that time Japan immediately banned all shipments of U.S. potatoes.

USDA's Animal and Plant Health Inspection Service has been working closely with MAFF over the past year to provide information necessary to lift the ban. The lifting of the ban on Wednesday excluded potatoes from Idaho.

¶19. (SBU) No Economic Impact from Avian Flu in Okayama -- Yet

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According to Japanese government officials, the January 27 discovery in Okayama Prefecture of Japan's seventh case of H5N1 Avian Influenza has not adversely affected poultry prices or sales volumes to date. All 12,000 chickens in the affected farm were culled and disinfected within three days. The same officials suspect the source of the infections to be migratory birds from Mongolia and northern China.

Rapidly setting up emergency disaster headquarters in Okayama, local officials appear to have learned from bitter experiences in Kyoto in 2004, when the spread of the virus went unreported for more than a week, resulting in a massive cull, a decline in consumer confidence, and the suicide of a poultry farm owner. Local MAFF offices conducted inspections throughout the region and directed several stores to remove inappropriate signs touting "no Okayama eggs or meat" and "no Miyazaki products" from their stores. Post is reporting separately to EST Tokyo on the local AI situation.

¶20. Ports: Cost Reductions, Efficiency Boost Planned for Hanshin Super Core Port (U)

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As part of the GOJ Ministry of Finance (MOF) 52.4 billion yen (\$437 million) 'Super Core Port' project, the Hanshin (Osaka-Kobe) port will be dredged to a new depth of 16 meters by the end of fiscal 2008 in order to facilitate super-large ships in Osaka Bay.

Operation costs at the Hanshin port will be cut by 30 percent and

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cargo loading/unloading time will be shortened in fiscal 2009 through enhanced coordination of facilities and a software upgrade.

The ports of Osaka Bay have been developed in a chaotic bureaucratic hodgepodge of jurisdictions, which has served to throttle efficiency in port services and reduce the competitiveness of the regional economy.

Last September, regional leaders launched a working group designed to promote the comprehensive linkage of the four international trading ports of Kobe, Osaka, Amagasaki-Nishinomiya-Ashiya and Sakai-Semboku.

Under the project, the four Osaka Bay ports will be treated as a single port, and tonnage dues paid by foreign vessels will be unified and streamlined starting in JFY 2007.

121. (U) Civair: Japan-Canada Aviation Talks Conclude

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MLIT announced on its web page that bilateral aviation talks with Canada were concluded in Ottawa in January. The bilateral negotiations were lead by Tadashi Shimura, Director of International Airport Division, MLIT and by Nadir Patel from Canada's Department of Foreign Affairs and International Trade. The talks gave seven new passenger flights to each side for service to/from airports other than Tokyo, such as Osaka. Also, Canadian airlines will change the current aircraft to a larger aircraft (B-777) for the existing routes out of Tokyo because the unit used to measure the air traffic will now be measured by number of flights rather than a coefficient unit as in the past. Unlimited flight numbers will be permitted for code shares with third country airlines as well.

Japan and Canada have had aviation relation since 1955 and JAL and Air Canada (code shared with ANA) fly seven flights per week between Narita-Vancouver, Toronto-Narita, Vancouver-Narita, and Vancouver-Kansai. The passenger numbers between the two countries were 790,000 and 796,000 in FY2004 and FY2005 respectively.

122. (SBU) MLIT Hires U.S. Consulting Firm for Basic Study on Airports and Competitiveness

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We recently learned that the Civil Aviation Bureau (JCAB) of Ministry of Land, Infrastructure and Transport (MLIT) has been conducting a basic study on airports' roles and competitiveness in other countries.

JCAB engaged a U.S. consulting firm in August 2006 to survey foreign airports on: roles of multiple airports in metropolitan areas and international competitiveness of those airports. Studies were conducted in cities such as London, Paris and New York for the first topic and Dubai and Istanbul for the second.

As a part this study, an ACCJ member told us that the U.S. consulting firm has reached out to foreign airlines about how they could run airport operations better on behalf of MLIT. The study is expected to be completed by the end of 2007, but it is yet to be determined how or if the GOJ will implement the final report.

123. (U) JAL's Plan with Eight Percent Layoffs and Pay Cuts

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Japan Airlines announced a medium-term corporate business plan for the four years FY2007 to March 2011 on February 6.

Through reduction of 4,300 employees, an early retirement allowance program, executive pay cuts of 45-60 percent, a general review of its domestic and international routes, and introducing first-class service on domestic routes and premium economy on international routes, the company seeks to prepare itself to take maximum advantage of the internationalization and expansion of Haneda Airport and the increase of slots at Narita Airport after 2009.

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The airline outlined five goals: improvement of safety standards; improvement profitability through cost reductions; downsizing through aircraft renewal and strengthening aircraft competitiveness; shifting to high profit routes and strengthening overall product competitiveness and; concentrating resources to the air transport segment.

For the company's international flights, JAL plans to increase its share of China services from 27 percent in 2006 to 33 percent by 2010. It also plans to increase the flights between Tokyo and New York, Paris, Moscow, and Delhi in 2007, but plans to reduce flights between Tokyo and Hong Kong and Guangzhou, and cancel

routes between Tokyo and Zurich, and Osaka-Brisbane-Sydney. JAL is also scheduled to join One World this April.

**¶24. (SBU) Bid-Rigging Post Mortem: Wakayama Wants More National Money for Road Construction**  
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New Wakayama Governor Yoshinobu Nisaka, a former METI bureaucrat, mentioned at a lecture at the Kansai Press Club that Wakayama planned to build more national roads in the prefecture, which has the least developed highway system in the six-prefecture Kansai region.

National roads are funded and managed by the national government, but there is a type of national road that the prefecture could manage on its own and still receive a GOJ subsidy.

Governor Nisaka said his prefecture's budget was too tight to improve the road system on its own, and he instead wants to push for national funds for new road projects, citing the economic benefits from tourism promotion and disaster prevention measures.

Governor Nisaka has to tread carefully to avoid becoming overly identified with new public works projects, given his predecessor's arrest in connection with bid-rigging on a public tunnel project and allegations of massive bribery.

SCHIEFFER